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PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Telecommunications Division **RESOLUTION T-16720**
Carrier Branch **March 13, 2003**

R E S O L U T I O N

RESOLUTION T-16720. THE EVANS TELEPHONE COMPANY. (U-1008-C). GENERAL RATE CASE FILING IN COMPLIANCE WITH G. O. 96-A, PARAGRAPH VI, AND DECISION NUMBERS 01-02-018 AND 01-05-031.

BY ADVICE LETTER NO. 326 FILED DECEMBER 19, 2001.

Summary

This resolution addresses the General Rate Case filed by Evans Telephone Company (Evans) through Advice Letter (AL) 326 on December 19, 2001 in compliance with D.01-05-031. In AL 326, Evans proposes: a) no change in its rates or charges, b) an intrastate Rate of Return (ROR) of 10.00%, the same granted by T-16007 in 1997 and, c) an increase of $160,863 in its California High Cost Fund-A (CHCF-A) draw for 2003 over its 2002 draw.

This resolution authorizes total intrastate revenue in the amount of $9,652,486 for Evans for the test year 2003. This represents a reduction of $1,943,414 to Evans' estimate of $11,595,900 for total intrastate revenue for 2003. The Total Intrastate Rate Base amount for Evans is $8,736,731 with an overall Intrastate Rate of Return of 10.00% for the test year 2003. Evans had requested a Total Intrastate Rate Base amount of $12,756,407 for an authorized Overall Intrastate Rate of Return of 10.00%. Also authorized by this resolution is California High Cost Fund-A (CHCF-A) support for Evans for test year 2003 of $1,048,675. Evans had requested CHCF-A support for 2003 of $3,627,318.

A comparison of the Telecommunications Division (TD) and Evans' Test Year 2003 Total Company Results of Operations before any CHCF-A adjustment is attached as Appendix A. Appendix B compares TD's and Evans' Separated Results of Operations before any CHCF-A adjustment. Appendix C compares Evans' and TD's Intrastate

Results of Operations estimates for test year 2003. Appendix D shows TD's calculation of the Net-to-Gross Multiplier and the change in the gross intrastate revenue requirement based on the recommended intrastate rate of return of 10.00%. Appendix E is a copy of the adopted conditions the Commission approved in Decision No. 01-06-084 authorizing the sale of Evans to Country Road Communications in 2001.

Background

The Evans Telephone Company (Evans), a local exchange telephone utility based in Turlock, California, provides local exchange telephone service in portions of Merced, Stanislaus, Santa Clara, and Yolo Counties, serving approximately 12,500 access lines in the following exchanges and rate areas: Guinda, Patterson, Livingston, Capay, Westley, Cressey, and Grayson.

Country Road Communications filed an application on September 19, 2000 to purchase Evans Telephone Company. The Commission granted authority to purchase on June 28, 2001, in D. 01-06-084, contingent upon seven conditions as listed in Appendix E.

On December 19, 2001, Evans filed Advice Letter (AL) No. 326 in response to D.01-05-031, in which the California Public Utilities Commission (CPUC) set in motion the waterfall[1] provision in 2002 for six small LECs if they do not each file a General Rate Case (GRC) by the end of 2001.[2] The last GRC filed by Evans was in 1995 through AL No. 206 and its most recent intrastate results of operations was authorized by Resolution T-16007 dated April 9, 1997.

In AL 326, Evans proposes: a) no changes to its rates or charges, b) an intrastate ROR of 10.00%, the same return as granted by T-16007 in 1997, and c) an increase of $160,863 in its CHCF-A draw for 2003 over its 2002 draw for a total of $3,627,318.

Notice/Protests

Evans states that a copy of the Advice Letter was mailed to competing and adjacent utilities and/or other utilities. Notice of AL 326 was published in the Commission Daily Calendar of December 21, 2001. Notice of the AL filing was made to customers by bill insert on December 19, 2001. No protest to this AL filing has been received.

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[1] The waterfall provision refers to the 6-year phase down of the CHCF-A funding level beginning in 1998, the year after the completion of a GRC. The funding levels are 100% of the for the first 3 years, i.e., 1998, 1999 and 2000; 80 % the fourth year, i.e., 2001, 50% the fifth year, i.e., 2002; and 0% thereafter.

[2] The six companies are Evans Telephone Company, Happy Valley Telephone Company, The Ponderosa Telephone Company, Sierra Telephone Company, Inc., The Siskiyou Telephone Company, and The Evans Telephone Company.

TD held a Public Meeting in Turlock on August 15, 2002, at which time Evans was given an opportunity to explain its filing to its customers and its customers were given the chance to ask questions of Evans and TD. Evans' customers were given notice of the Public Meeting through bill inserts. The notice of Public Meeting was also published in the CPUC Daily Calendar. One customer attended the Public Meeting.

Discussion

Results of Operations

Appendix A sets forth Evans' total company results of operations for test year 2003, as estimated by TD and Evans.

Operating Revenue

A comparison of TD's and Evans' estimates of total operating revenues for test year 2003 is shown in Appendix A. Evans' estimate for total company operating revenues is $14,871,721 a difference of $635,226 from TD's estimate of $15,506,950. The differences between TD's and Evans' estimates are further described below.

In determining the test year Operating Revenues, TD reviewed Evans' methodology, calculations, and assumptions for the proposed test year of 2003. Evans' revenue accounts included both recurring and non-recurring basic local service revenue and recurring customer premises revenue. Evans' revenue estimates are based on a 2.24% yearly growth rate increase that Evans applies to its calculation of six-month actual and six-month annualized 2001 data to estimate revenues for 2002 and 2003. Evans arrived at its 2.24% growth rate by using year-end percent changes to its access line growth from 1996 to 2001 and taking into consideration the loss to second lines due to cellular and cable competition for the years 2002 and 2003.

Based on a regression analysis of Evans' historical average access line growth from 1996 through 2001 TD estimated the growth rate to be 5.65% over the five years. The coefficient of determination from the regression analysis, which measures the strength of the relationship between the actual historical figures and the regression line growth calculations, was 99%. A coefficient of determination closer to one (100%) indicates a greater degree of relationship. In addition, field inspection of Evans' serving areas and information on population and housing growth collected from planning officials of the cities of Patterson and Livingston, supported TD's 5.65% estimate. Therefore, TD did not accept Evans' projections for access line growth.

TD applied the 5.65% five-year growth rate increase to arrive at the 2002 and 2003 average access lines of 13,055 and 13,645, respectively. To arrive at its 2003 estimates, TD then applied the 5.65% percentage growth rate over all individual line items for Evans' basic local service revenue, customer premises revenue, and other local exchange revenue accounts.

For Rent revenues, TD verified Evans’ 2001 annual amount to be $67,613. For its 2002 and 2003 revenues, Evans’ provided estimates of $56,179 and $48,244, respectively. TD reviewed the years 1997-2001 and calculated the average arithmetic mean to estimate 2002 and 2003 revenues for this item. TD compared its calculations to Evans’ and noted that the variance in estimates was not significant enough to justify changing Evans’ estimates. Therefore, TD accepts Evans’s 2003 estimates, as submitted.

For Other incidental regulated revenues, TD verified Evans’ 2001 annual amount to be $113,275. TD reviewed D. 01-02-013 which approved the Settlement Transition Agreement (STA) between Pacific Bell and Small ILECs. TD also verified that Pacific’s monthly STA payments to Evans, for SS7 and 800 DB/LNP queries, ended on June 30, 2001. For its 2002 and 2003 revenues, Evans’ provided estimates of $1,792 and $1,809, respectively. TD reviewed the supportive documentation for all remaining items encompassed in other incidental regulated revenues and accepted Evans’ 2003 estimates, as submitted.

For access revenues, Intrastate - intraLATA and interLATA, Evans used a five-year average percentage rate over access minutes of use (AMOU) billings from 1995-2000 to estimate 2003 revenues for these items. Evans derived a 9.1% increase for intraLATA minutes and a 3.6% increase for interLATA minutes. However, TD did not accept Evans’ projections. TD reviewed Evans’ AMOU from 1996 through 2001 and compiled the historical average AMOU growth amounts for intraLATA and interLATA. TD then tested these growth amounts using regression analysis. The coefficient of determination of the regression analysis is 91% for intraLATA and 95% for interLATA. TD’s calculations of the growth rate amounts and the average percentage rates for intraLATA and interLATA, for the test year 2003, indicated 5.05% and 10.35% growths, respectively. TD then applied these percentage growth rates over access minutes of use billing to arrive at its 2003 access revenue estimates.

For Federal USF support, TD verified Evans’ 2001 “high cost loop fund (USAC)” annual amount to be $468,895. To reflect the actual federal universal service fund support for 2002, TD requested that Evans provide a copy of its disbursement notices received from the National Exchange Carrier Association (NECA). The notice from NECA showed that Evans’ actual 2002 “high cost loop fund (USAC)” amount as $436,716. TD used this figure as Evans’ 2002 federal USF support. For its 2003 estimate, Evans provided a copy of the 2003 USF annual compensation estimate of $68,455, that it provided to NECA. TD verified and accepted this estimate.

Evans’ CHCF-A support request for test year 2003 is $3,627,318. TD finds reasonable Evans’ estimate for this item based on present rates and conditions. However, upon TD review of the rates and charges of services offered by Evans, TD recommends reducing Evans' 2003 CHCF-A support by $3,611,119 to $16,199.

For Directory revenues, TD did not accept Evans' projections for directory revenues, where no methodology was applied. TD 's regression analysis found the coefficient of determination to be too low at 68%. TD calculated a five-year average percentage rate increase of 3.19% using data from 1997 to 2001 to estimate 2003 revenues for this item.

TD did not accept Evans' projections for other incidental revenues - late charges, because Evans failed to demonstrate a reasonable estimation method. TD's regression analysis found the coefficient of determination to be too low at 68%. TD calculated a five-year average percentage rate increase of 1.62% using recorded 1997 to 2001 data to estimate 2003 revenues for this item.

TD did not accept Evans' projections for uncollectibles, because Evans failed to demonstrate a reasonable estimation method. TD used the six-year average percentage rate over basic local service billings from 1996 to 2001 of 1.5% to estimate 2003 uncollectibles.

Operating Expenses

The purpose of the expense estimates is to set an expense level for ratemaking and not necessarily to estimate any particular expense or component of expense. For the expenses, the utility provided recorded expense levels for years 1996 through 2000. For 2001, Evans used a six-month recorded expense and annualized this value for the 2001 estimate. Evans then used the 2001 estimate to estimate the expenses for 2002 and 2003 by increasing it for inflation.

Since Country Road purchased Evans expense levels increased significantly, primarily in the administrative and general expense categories. In general, there was a fairly consistent historical expense level through the year 2000, prior to the acquisition, with a substantial increase in 2001. Many of the expense estimates increased by a factor of 2.5 or more from the recorded pre-2001 levels.

TD used the 2001 annual report to update the 2001 expenses to actual recorded numbers. The accounts are reported in several separate components: salaries, benefits, rent and other. These components were analyzed graphically. There seems to be no consistent relationship between salaries and benefits. TD reviewed the recorded expenses using two-year through six-year constant dollar averages and choosing the three-year average because it is more representative of average expense levels for rate setting.

TD used a constant dollar average method based on three years of recorded expenses adjusted for inflation with the inflation factors developed by the Office of Ratepayer Advocates. The labor adjustment factor was used for salaries and benefits while the non-labor factor was used for all other category components. While expenses have been increasing in nominal dollars, when one applies the constant dollar method and adjusts the recorded figures to base year constant dollars, there is less of a variance and in many cases, the inflation-adjusted figures remained relatively flat. TD used Evans' recorded expense figures as reflected in the utility's workpapers and annual reports for the years 1999, 2000 and 2001[3] and then applied the inflation factors for labor and non-labor for each year. [4]

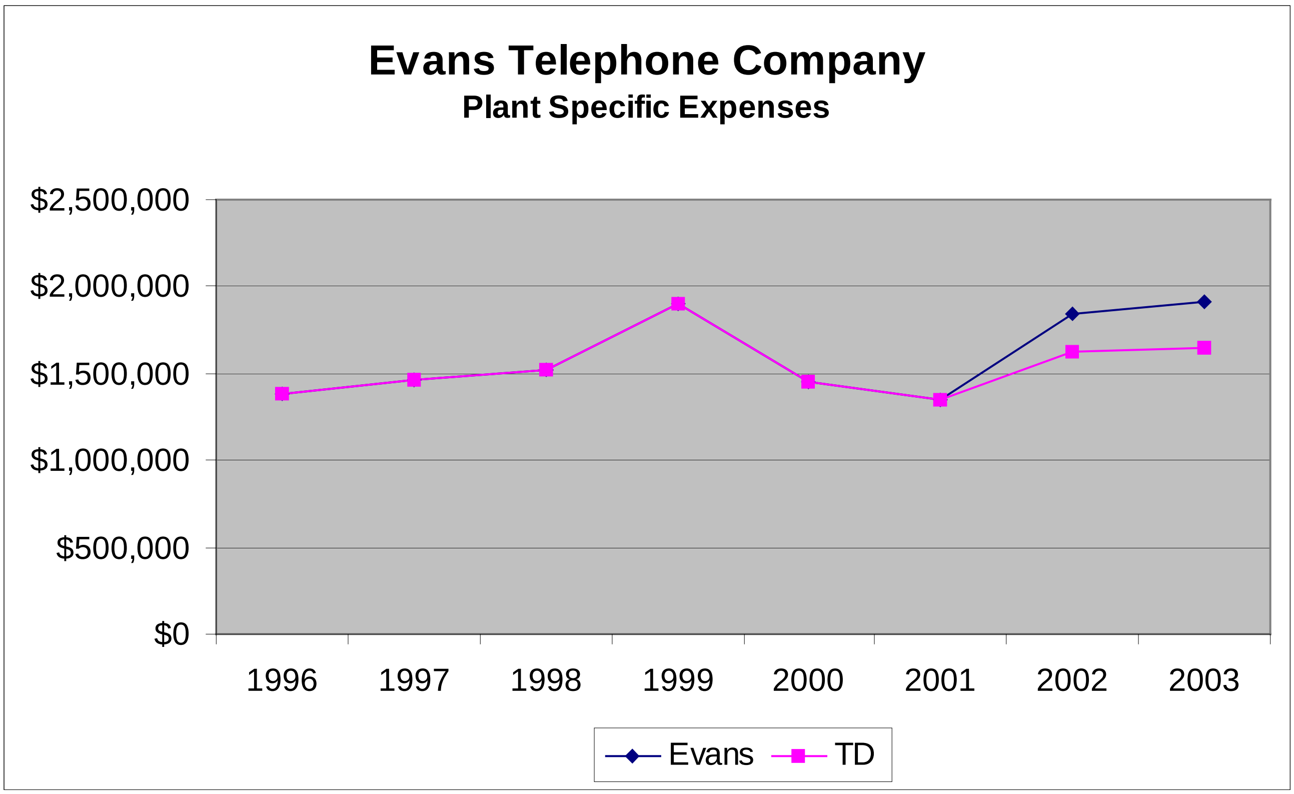
The expense accounts are separated into four general categories. These categories are Plant Specific, Plant Non-specific, Customer Operations and Corporate Operations. Within each of these there are sub-accounts that are separated into each of the components. For some components, TD's estimates were above those of Evans. However, in general the estimates were below those of Evans for the test year. TD's estimates are generally above the historical levels for the expenses.

[3] Form M Schedule I-1 (FCC Armis 43-02 Report Format) of Evans's Annual Reports for 1999, 2000 and 2001.
[4] TD used the Office of Ratepayers Advocates estimates of Non-Labor and Wage Escalation Factors for 2002-2004 from the March 2002 DRI-WEFA U.S. Economic Outlook as follows:

Year	Labor	Non-labor
1999	1.022	1.007
2000	1.034	1.036
2001	1.028	1.000
2002	1.016	1.000
2003	1.017	1.022

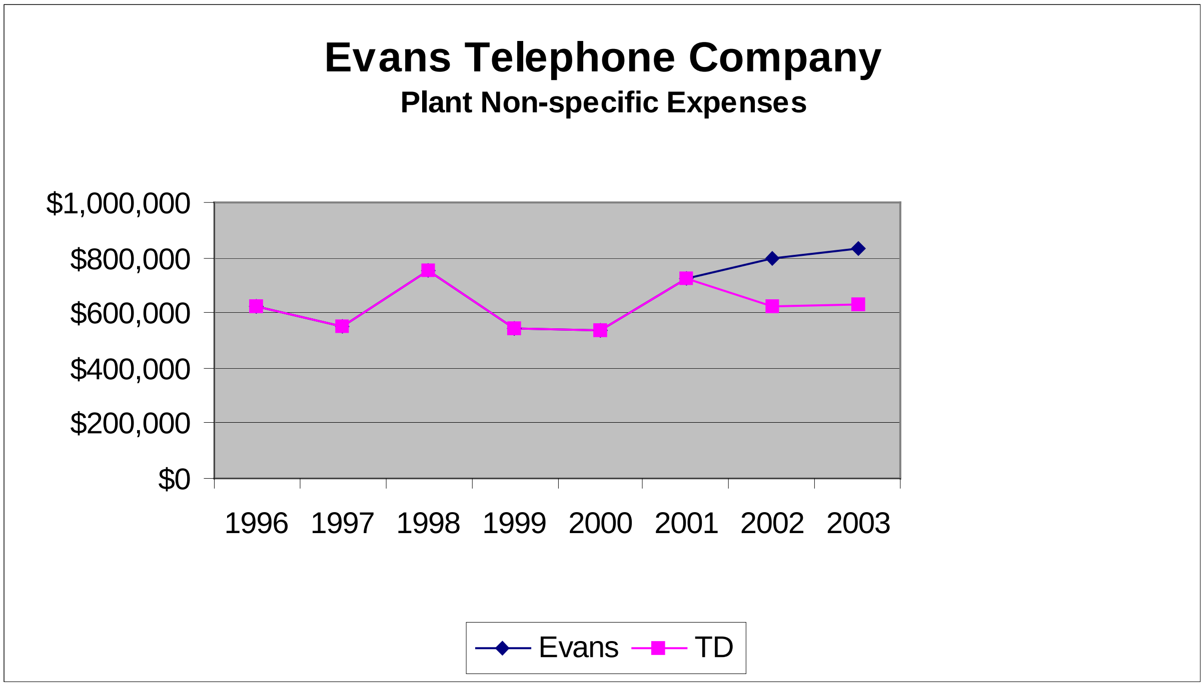
Plant Specific Expenses

Plant specific expenses include expenses related to telephone plant. These include components for motor vehicles, other vehicles, land and building, furniture and expenses related to cable wiring and central office equipment. TD's estimates for Plant Specific expenses are $1,621,600 for 2002 and $1,652,900 for 2003. Evan's estimates for the two years are $1,843,447 for 2002 and $1,916,539 for 2003. The graph below illustrates the estimates for all components of the plant specific expense accounts.



Plant Non-Specific Expenses

Plant Non-Specific expenses include such expenses as those related to network administration, testing, engineering access to the network and power. TD's estimates for Plant Non-Specific expense are $621,200 for 2002 and $632,700 for 2003. Evan's estimates for the two years are $794,307 for 2002 and $834,024 for 2003. The graph below shows the estimates for all components of the plant non-specific expenses.



Customer Operations Expense

Customer operation expense includes expenses related to call completion services, number services, customer services, customer billing and carrier access billing. TD's estimates for customer operations expense are $1,252,100 for 2002 and $1,263,100 for 2003. Evan's estimates for 2002 and 2003 are $1,601,458 and $1,674,404, respectively.

Carrier access billing expense showed a substantial increase for 2001. In response to a TD data request, Evans reported that the expense for this function was recorded in the general and administrative and information management expense in prior years. The amounts were removed from those corporate expense categories and transferred to the carrier access billing expense category. The amount transferred in 2001 was $124,902.70 from information management and $23,500 from general and administrative. In addition, Evans reported that there were additional amounts related to three customer service representatives for the period 2000 to 2003. TD did not include this additional amount in the customer operations expense for the new employees because TD believes the Customer Operations estimation method applied provides a reasonable estimate of the total expense.

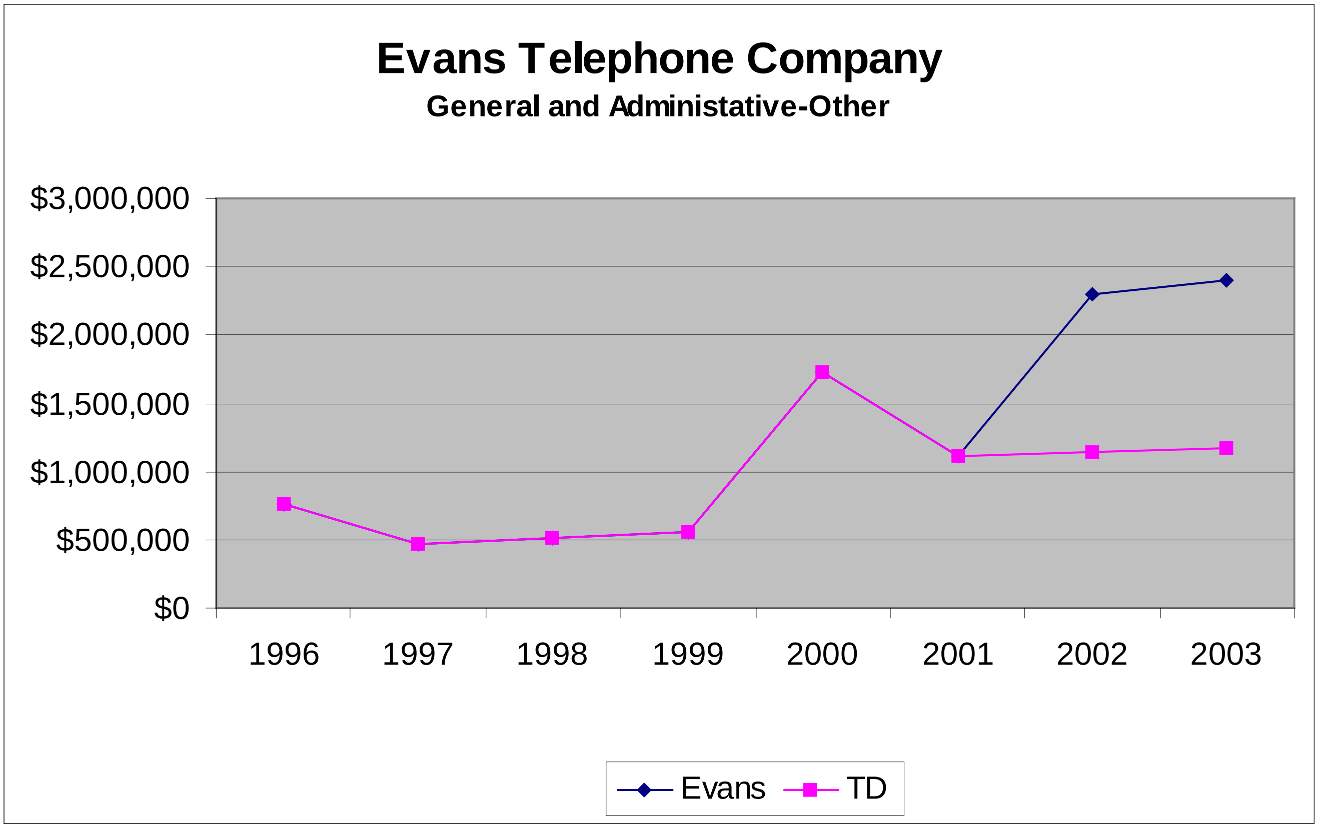
Corporate Operations Expense

The corporate operations expense includes five categories of expenses. They are Executive and Planning, General and Administrative, Accounting & Financial, Human Resources and Information Management. The corporate operations expense has shown a significant increase in expense levels even though some of the expenses were, as described above, transferred from the corporate operations expense to the customer operations expense.

TD's corporate expense estimate for 2002 and 2003 are $3,057,500 and $3,117,800, respectively. Evans' corresponding estimates are $4,249,820 for 2002 and $4,454,705 for 2003. There are significant differences in the estimate of corporate expense for the years 2002 and 2003. After an analysis of each component of each expense category in the corporate expense, the major difference is in General and Administrative Expense, Other component. The other component includes expense-other than salaries and benefits.

The following graph shows the Other component of the General and Administrative account. The purchase of Evans by Country Road resulted in a very significant increase in General and Administrative expenses over the historical levels. Subsequent to the purchase by Country Road, the local management has remained essentially the same with the people performing the same management and administrative functions. The only difference is the change in ownership.

The purchase by Country Road should not have resulted in an increase in operating expenses since Decision (D.) 01-06-84, Appendix A, Adopted Condition 2 stated: "Evans Telephone shall not increase rates for its customers due to any increase in costs brought about by its acquisition by Country Road and Evans Holdings." Because of this condition, TD recommends that the additional general and administrative expenses attributed to the acquisition of Evans by Country Road should be disallowed.



On September 4, 2002, TD requested specific information on Evans corporate fees for 1999 through 2003. The written response dated September 11, 2002 states that "during 1999 and 2000 the expenditures relate primarily to the Evans Family corporate operation expense. There was less involvement of the Evans Family related to the detailed operations of the company, for 2001, 2002 & 2003 the expenditures relate to Country Road Communications." Evans also stated that, "Country Roads Communications provides greater day to day involvement in the operations of the company and is much more analytical."

However, as stated in Appendix E, Adopted Condition 3 of D 01-06-084, "Evans Telephone shall manage its finances on a stand-alone basis, independent of Country Road, CRC Communications of California, and other affiliates. " Clearly, to have so much money charged by Country Road for functions that have been sufficiently provided in the past by Evans' own staff is unnecessary.

The customers of Evans should pay for administrative and general expenses that are required for the operation of the company and not for additional layers of management and for expenses related to the strict reporting requirements of the banks and lenders that are required because of the debt level of its parent corporation.

Depreciation

Both TD and Evans applied the same depreciation rates to average plant in service. The significant differences in the depreciation estimates are due to several items. Evans had initially planned to retire some switching equipment in 2001 for $2,100,000; however the equipment was not retired. Also in 2001, the depreciation accrual for General Purpose Computers was $22,521 while the recorded amount in Evans' annual report for 2001 was $212,520. Therefore TD used the recorded number from the annual report. The $212,520 figure closely matched the depreciation accrual calculated from the depreciation rate for that account. TD's total depreciation estimate is $24,734,600, an increase of $2,636,950 over Evans' estimate of $22,097,651 for the test year.

Depreciation Reserve

Evans supplied workpapers showing the historical development of its test year depreciation reserve. In the workpapers, the accruals and retirements were often lumped together with other debits and credits. TD separated the accrual and retirement from the amount recorded and entered the excess as an adjustment. The historical depreciation reserve was not changed.

For 2002 and 2003, Evans included a cost of removal along with retirements. On inquiry, Evans stated that the cost of removal was based on a historical relationship between retirements and cost of removal. TD's analysis showed that for the test year Evans' cost of removal was a constant 97.4% of the estimated retirement and this figure was applied to all retirements regardless of the type of plant and the need for removal. Retired computers, licensed vehicles and underground cable each had associated with it a 97.4% cost of removal. Because the historical records did not show any relationship for cost of removal for retired plant, TD removed these amounts. Evans estimated the cost of removal for 2002 at $355,240 and for 2003 the amount was $326,146. For 2001 the recorded cost of removal was $2,976 even though Evans estimated some substantial retirements including $2,100,000 for switch equipment. TD estimated the cost of removal at $800 for 2002 and $1,200 for 2003.

Taxes

The differences in tax estimates are due to variations in Evans' and TD's estimates of income, revenue and expense. TD and Evans each used a Corporate State Franchise Tax (CCFT) rate of 8.84% and a federal income tax rate of 34.00%. The interest deduction for Evans was originally a nominal amount for each year calculated at 5% of the total debt. Subsequently Evans provided an amortization schedule for debt of $1,750,000 and the interest calculated in the amortization was used in the TD income tax calculations. TD's estimates for Total Company Federal and State taxes are $1,691,125 and $482,330 respectively for the test year.

Rate Base

Evans' estimate of average plant-in-service for test year 2003 is $37,724,333. TD lowered Evans' total company telephone-plant-in-service estimate by 17.30% to $31,200,040. This difference of $6,524,293 is the result of two adjustments by TD to Evans' estimate as described below:

TD's first adjustment to plant-in-service was to reinstate $2,100,000 of digital switch equipment that had been scheduled for retirement in 2001. Evans informed TD that the equipment would remain in use and therefore should be included in current plant estimates.

The second adjustment of $7,474,900 TD applied to plant-in-service is due to the conditions of sale set forth in Adopted Condition 7 of Appendix A in D. 01-06-084 (see Appendix E) in which the Commission stated that, "Country Road shall invest approximately $11 million in network infrastructure for Evans Telephone over the next five years…without increasing local rates".

In response to a TD data request Evans made the following statement in writing on May 9, 2002 regarding its compliance with D. 01-06-084, "Capital expenditures for 2002-2003 are projected to be…$9.7 million in the first two years after the sale to Country Road. With these capital budgets, Country Road is well on the way to complying with the requirement in Decision 01-06-084…"

To fulfill the requirements set forth in D. 01-06-084, TD removed for ratemaking purposes Evans' capital expenditures for 2002-2003. This was done because a) Evans identified these amounts as a portion of the required $11 million investment and b) including the estimated plant additions for 2002-2003 would directly result in a rate increase that is specifically prohibited by D. 01-06-084. Therefore, TD removed Evans' capital expenditures for 2002-2003 from rate base. However, all standard expenses associated with the plant additions remain. After 2003, Evans will have three years to invest the remaining balance of the $11 million dollar requirement.

In estimating its test year Rate Base, Evans included Construction Work in Progress (CWIP). TD excluded CWIP in the computation of its rate base estimate, because the utility, not the ratepayers, should shoulder the costs of construction until the project is used and useful. Evans, therefore, should not be allowed to earn a return on any plant or facility under construction until it becomes operational and is placed into service.

Evans used 0.69% of the average plant balance in determining its test year total company materials and supplies estimate of $259,444. Based on the recorded ratio of materials and supplies expense to plant in service for the past five years 1997-2001, TD finds Evans estimates for this item to be unqualified. TD estimates a materials and supplies expense of $166,302 for the 2003 test year. TD's estimate is based on a five year recorded average of 0.43% of average plant balance for the years 1997-2001.

TD estimates Evans 2003 test year working cash requirement to be $716,843. This is $144,145 lower than that estimated by Evans. This difference is due to TD's lower operating expense and higher revenue estimates.

Separations

Evans provides both intrastate and interstate telecommunications services, subject to the regulation of the CPUC and FCC, respectively. Because Evans' property serves both jurisdictions, the utility's revenues, expenses, taxes, investments, and reserves are allocated between interstate and intrastate services.

Separations is the process of apportioning a telephone company's property costs, related reserves, operating expenses and taxes, and revenues between the state and interstate jurisdictions. It is a vehicle by which a telephone company can separately identify the amount of expenses, investments and revenues associated with the production of a given service. These apportionments are made on the basis of relative usage and direct assignment whenever possible. The costs to be apportioned are identified in the FCC Part 36 separations manual, according to the classification of accounts as prescribed by the FCC's Part 32, Uniform System of Accounts (USOA) for Telecommunications Companies.

Evans used separation factors based on its 2000 cost studies. TD reviewed Evans' separation factors and finds them to be reasonable. Therefore, TD used the separation factors provided by the company to separate its estimates of total company expenses and plant to derive TD's estimate of Evans' intrastate results of operations.

Appendix B compares Evans and TD interstate and intrastate results of operations for test year 2003 using these separation factors.

Cost of Capital

Evans requests an overall intrastate rate of return of 10.00%, the rate of return authorized by the Commission for Evans in 1997 by Resolution T-16007.

The Return on Equity for all rural ILECs should be the same since the systematic and non-diversifiable risks faced by all rural ILECs are similar. However, as a matter of practice, Decision D.97-04-036 in A.95-12-073[5] adopted an 'overall' rate of return of

[5] In D. 97-04-036 the Commission authorized California-Oregon Telephone Company a 10.00% return on rate base for its 1997 test year as requested in A. 95-12-073 (California-Oregon's 1997 General Rate Case application).

10.00% for all rural ILECs. Based on information provided, TD recommends that the Commission approve Evans' request for an overall rate of return of 10.00% at this time. This approval should not set a precedent for any future or pending small ILEC GRC proceeding.

Net-to-Gross Multiplier

The net-to-gross multiplier indicates the unit change in gross revenues required to produce a unit change in net revenues. Appendix D shows TD's computation of Evans' net-to-gross multiplier. The net-to-gross multiplier of 1.66208 means that a change of $1,662 in gross revenue would be required to produce a change of $1,000 in net revenue. For Evans, based on an adopted state rate base of $5,205,147 and an adopted rate of return of 10%, the adopted intrastate revenue requirement change required is $3,611,119.

CHCF-A Support

In 2002, Evans' draw from the CHCF-A was $3,466,455.

Appendix C shows Evans' intrastate results of operations using the 10.00% intrastate rate of return.

For test year 2003, TD 's computation of Evans' CHCF-A requirement is $1,048,675 based on TD's projected revenues, expenses, rate base and overall intrastate rate of return.

Comments

The draft resolution of the Telecommunications Division on this matter was mailed to the parties in accordance with PU Code Section 311 (g)(1).

On December 23, 2002 Cooper, White and Cooper, LLC (Cooper) filed timely comments on the behalf of Evans. Cooper raised the following issues with the draft resolution:

1. The draft resolution (DR) understates Evans' test year expenses.
2. The DR treats Evans' investment as a gift to ratepayers.
3. The DR improperly excludes CWIP from rate base.
4. The DR unrealistically overstates line growth and, therefore, revenue.

Comments on Expenses

Evans comments on the expenses addressed several issues but primarily the method that TD used to estimate expenses. TD used a constant dollar method (CDM) to estimate expenses for the test year. Evans notes that TD's estimate for the test year is less than the recorded expense level for 2001. They believe it is implausible that a company experiencing increasing costs over the last several years would realize lower expenses in the test year.

It is necessary to examine the trends of the expenses over the last few recorded years. For plant specific expense the recorded expenses show a decline from 1999 through 2001. Nevertheless Evans projected a significant increase for 2002 and 2003. For plant non-specific expense there was quite a bit of variability in the past with a significant decline from 1998 to 1999. The 2000 expenses were about the same as 1999 and 2001 was significantly increased over the 2000 level. It is not possible to discern a clear trend from these data. Evans projected a further increase for the test year. The customer operations expense shows a linear trend over the past six years.

The corporate expense fluctuated a bit between 1996 to 1999 with increases and decreases. In 2000 there was a 40% increase over the 1999 expense and a further 18.9% increase for 2001. Evan's estimate for 2002 was 15.9% above the recorded 2001 expense, and the 2003 estimate was increased by a further 4.8%. TD noted that the recorded corporate expense for 2001 included $545,515 of legal expenses. Although Evans estimated no legal expenses for the test year, the CDM included an average of the legal expense.

Evans provided a decision citation where the Commission rejected a 5-year CDM to estimate office supplies expense. In the analysis for this case TD examined CDM methods involving 1 through 6 years of recorded data in its estimate. TD also rejected a 5-year CDM method in this case. TD wished to use a consistent method for the different expense categories and after much analysis determined that the three-year average CDM provided a reasonable estimate.

Evans proposed several alternate methods of estimation other than the CDM. These include trending (linear regression), annualized actual data, budgeting forecast, and benchmarking. TD reviewed the methodology presented by Evans. Benchmarking involves comparison to other telephone companies and Evans concluded that since the expense level per customer for Evans is less than that for other companies that their higher estimates are justified. However, if the Evans family operated the company more efficiently than other companies it is no justification for their customers to have to pay more. Moreover the other companies do not have the same operating conditions as Evans.

Annualized actual data is basically the method that Evans used in its filing. It assumes that the partial year costs are representative and uniform. However the costs are not audited nor are they for an entire year. Evans points out that this method was used in the last general rate case in 1997 and they projected $5,228,373 for 1997 and the recorded expense was $5,119,275. However that is the recorded expense for 1996 and not for the test year of 1997.

2001 was also the year that CRC took over the operations of Evans from the Evans family. While CRC assured the Commission that they would maintain the same employees and that there would be no impact on the income, expense or operations of Evans, nevertheless the expenses show significant increases in 2001 over historical expense levels. Evans estimated even higher amounts for the test year, 2003. TD did not believe that the 2001 expense levels were representative of average or normal operating conditions.

TD reviewed the expense categories using linear regression. There have been some transfers of expense from one area to another. This complicates linear regression while with CDM it would average out. In addition the R-Squared values were low for most of the categories except for customer operations expense. Evans also notes that TD had included a higher customer growth rate than Evans did but did not include a growth in expenses that would correspond to the increase in customers. The Customer Operations Expense would relate more closely to the number of customers than the other expense categories. TD revised the estimate for customer operations expense relying on linear regression rather than CDM.

TD examined using linear regression on the four categories of accounts to compare to the estimation by the CDM. Of the four categories, only Customer Operations Expense showed a clear linear relationship with a high correlation coefficient. The coefficient of determination or R-squared is 0.946. This shows a very good linear relationship. Because of this TD will use the linear regression to estimate the expenses for this category.

The other categories of expense did not have a clear linear relationship. While linear regression can be used to estimate a number for the test year, absent a clear linear relationship, the estimate using linear regression would have dubious value. The corporate expense had the next highest r-squared value. TD believed that the inclusion of the $545,515 of 2001 legal expense would skew the regression line since additional expense at the end of the recorded period not only increases the expense level but also increases the slope of the line. With the legal expense omitted the trend line would estimate an expense level for 2003 about 11% higher than the CDM.

Although Evans's estimate of corporate expense has increased substantially above the historic levels, the estimate for corporate salaries and benefits using the staff methodology (CDM) is close to the levels estimated by Evans. When a utility undergoes a change in ownership there are often transitional costs that will occur pre and post transfer. Though, once the transition is complete, the corporate expense should revert to a normal level. Linear regression on the Corporate Expense did not result in an R-squared high enough to demonstrate a clear linear relationship.

Basically, the employees and operations of Evans are unchanged due to the change in ownership. Evans continues to have both a president and a CEO with additional management from CRC. Often after a purchase, the new ownership will find ways of consolidating functions or improving efficiency in ways that reduce costs. CRC has not implement such changes.

The budgeting forecast method basically uses the recorded 2001 expense levels as the base and applies and inflation factor to estimate for the test year. Since Country Road purchased the Evans Companies in 2001, there would be differences in expenses related to the transition; therefore 2001 may not be a representative year on a going-forward basis. Like any transition many of these would be one-time expenses and the CDM would average them with prior expense levels to result in a reasonable estimate for continuing the business operations.

CRC provides some additional services to Evans such as corporate management (without concomitantly reducing management within Evans), treasury and access to greater capital markets. Yet Evans seemed to have little problems with those services prior to the purchase and provided them at a lower cost. There is no evidence of an infusion of capital into Evans facilitated by access to broader capital markets.

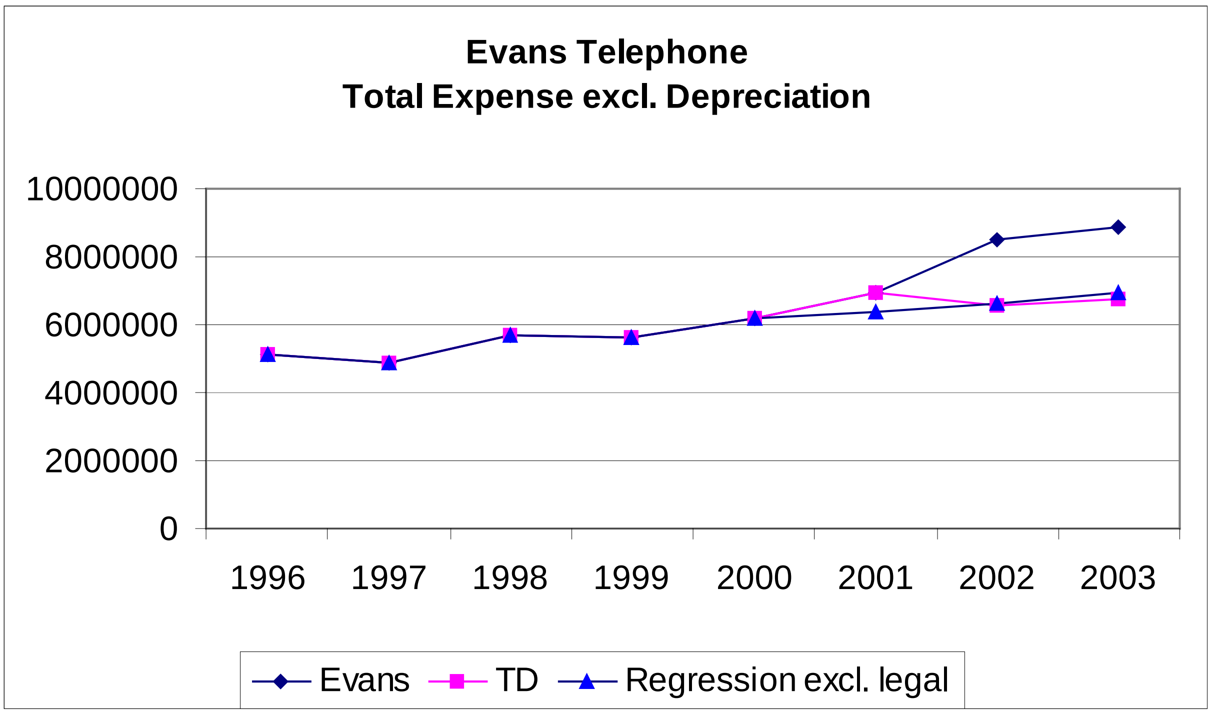
Evans stated that the medical benefit costs had increased by 25% and this would not be taken into account with the CDM. In reviewing just the total benefit component of each of the four expense categories, TD notes that for three of them the CDM matches closely with the estimates made by Evans. Only in Customer Operations Expense does the CDM possibly understate the benefit amount. TD changed from the CDM to linear regression for this expense category resulting in a higher cost estimate for this Customer Operations Expense.

Evans also believed that the inflation factors were used for the wrong years, however ORA lags the payroll factors by a year to match the practice of the major labor unions. The labor unions use the prior year's inflation as an adjustment for the current year.

Furthermore, Decision (D.) 01-06-084 states

> "The acquisition involves only the sale of stock of Evans Telephone and there will be no impact on the income, expense, assets, liabilities, or operation of Evans Telephone. The financial statements of Evans Telephone will be unaffected, as will it regulatory financial reporting and other requirements."

However the graph below shows the total expense with Evans estimates for the years 2002 and 2003. Evans estimates are significantly above the historical levels. The TD estimates using the CDM for three of the components and using regression for customer operations expense are the boxes and the regression after omitting the legal expenses for 2001 are the triangles. The regression would result in about a 3% increase in expense level over the revised staff estimate for 2003. The coefficient of determination for this regression was 0.869 showing a linear trend. TD does not believe that regression on total expense level should be used to estimate test year expenses. However the regression does provide additional information and analysis.



Upon receiving additional and updated information from the utility TD recognizes the need for additional adjustments to expenses related to its adjusted access line growth estimates. The utility has demonstrated a need for additional employees to undertake the increased workload of the additional access lines and resulting customers. TD finds this need to be reasonable and therefore has increased its estimates for the following categories Customer Operations, Corporate Operations, and Plant Specific expenses. These increases are further explained below.

The Customer Operations expense estimate has been increased for the addition of two employees. These employees are a Service Center Representative for residential services and a Customer Service Representative for business services at total cost of $100,695.

The Corporate Operations expense estimate has been increased for the addition of three employees. These employees are a President, Programmer, and Systems Operator at a total cost of $294,632.

The Plant Specific expense estimate has been increased for the addition of two employees. These employees are an Outside Technician and an Inside Technician at a total cost of $120,270.

With regard to the exclusion of CWIP, Evans asserts that the exclusion of CWIP is contrary to Commission practice and that the recently approved rate cases of Volcano and Siskiyou Telephone companies were approved with the inclusion of CWIP. TD acknowledges that the Commission has historically allowed the inclusion of short term CWIP. Since comment Evans has verified with TD that their estimated amount of $275,878 is for short term CWIP. TD also recognizes that Resolutions T-16697 and T-16707 authorized CWIP for the accompanying utilities. Therefore TD finding Evans estimate reasonable and now recommends the inclusion of Evans short term CWIP estimate in the amount of $278,878.

Evans' argues that the DR incorrectly disallows $9,809,549 of plant investment. Evans contends that, a) the DR makes an incorrect interpretation of the intent of D.01-06-084 by treating the investment as a gift to ratepayers, b) that Evans did not propose any increases in rates consistent with the conditions of D.01-06-084 and lastly, c) that the disallowance is unconstitutional and qualifies as regulatory taking. Evans also contends that the disallowance would have a drastic impact on the financial health of the company.

After consideration of Evans' comments TD maintains that its interpretation correctly undertakes implementation of the conditions of the decision. However, after new and additional information was provided by Evans TD has made adjustments to its estimates in order to lessen the financial impact on the company. TD has therefore annualized the $11 million dollar requirement over 5 years rather than removing the greater majority in the first two years. TD has implemented this by removing $2.2 million from rate base expenditures per year for 5 years. This change results in an increase of over $3 million in rate base for the test year that Evans will earn return on. The rate base amount estimated in the DR was $24,027,151 and will be increased to $27,242,241. TD contends that this amount should assure the companies financial viability while also complying with the conditions of D.01-06-087.

In addition TD states that Evans is then required to spend at least $2.2 million per year without return on those amounts for the years 2004, 2005, 2006 to meet the required $11 million investment condition set forth in D.01-06-084. Evans will also be allowed return on any necessary investment above the $2.2 million per year. After the fifth year Evans will be allowed return on its total rate base including the disallowed amount totaling $11 million.

Evan argues that TD has overstated access line growth for three reasons. Fist, that they are loosing customers to wireless competition. Second, that the availability of cable modem service has resulted in the loss of second lines. And finally third, that they are loosing business lines due to poor economic conditions.

Based upon a re-analysis of all data collected through, field inspection of the areas served by Evans' discussions with and population growth rate data received from the planning officials from the city's of Patterson and Livingston, TD staff established that there is continued growth and new development throughout Evans' service area.

Historically, access lines for the cities of Patterson and Livingston account for approximately 88% of Evans' total access lines. After contacting the city officials of Patterson and Livingston, TD staff verified the estimated number of (new) construction units, in these areas, has continued to grow over the past year to 18 months. This trend is expected to continue throughout 2003. In addition, several new subdivisions are set to begin construction within the next 6 months.

When developing their access line growth estimate TD did take into consideration the three factors that Evans' raises and adjusted their estimate accordingly. The 5.65% five year growth rate projection TD contends is a reflection of the net growth of access lines after line loss has been adjusted for.

Commission approval is based on the specifics of this Advice Letter and does not establish a precedent for the contents of any future filings by small ILECs.

Findings

1. Evans filed its GRC on December 19, 2001, with a Test Year of 2003 in compliance with Decision No.01-05-031.

2. Evans requests the following for test year 2003:

    - No change in its rate or charges,
    - An intrastate rate of return of 10.00%, the same return granted to them in its last GRC filing in 1997, and
    - An increase in its CHCF-A draw for 2003 over 2002 of $160,863 for a 2003 CHCF-A support of $3,627,318.

3. The Telecommunications Division recommends the following for Evans for test year 2003:

    - A total intrastate rate base amount of $8,736,731; and
    - An Intrastate Rate of Return of 10.00%.
    - A California High Cost Fund-A (CHCF-A) support of $1,048,675 representing a reduction of $2,586,362 from Evan's CHCF-A 2003 support estimate;
    - A revenue requirement reduction of $2,578,643;

4. The differences in the estimates of Evans and TD result from the use of different methodologies for estimating revenue, expenses, and rate base.

5. We find TD's methodology in estimating revenues reasonable. We therefore, adopt TD's recommended intrastate revenues as shown in Appendix C.

6. We accept TD's recommended overall rate of return of 10.00% for Evans.

7. We find Evans' Depreciation Study previously approved by the Commission, as part of its 1997 rate case is acceptable for ratemaking purposes for the test year 2003.

8. We find TD's recommended reduction of CHCF-A support for Evans for 2003 acceptable. The reduction in CHCF-A support is based on our adoption of TD's Intrastate Results of Operations for Evans for test year 2003.

THEREFORE, IT IS ORDERED that:

1. The intrastate revenues, expenses, and rate base amounts for test year 2003 identified in Appendix C are adopted for The Evans Telephone Company.

2. The overall intrastate rate of return of 10.00% is adopted for Evans.

3. Evans' CHCF-A yearly support for 2003 is $1,048,675 with a resulting monthly support of $87,389.

4. This resolution directs TD in concert with the Information and Management Services Division to pay Evans monthly support payments in the amount indicated above in accordance with the payment timeline set forth in D.01-09-064. The payment of monthly support to Evans is contingent on the availability of funds and the Commission and State adoption of the budgets covering the payment for the 2003 CHCF-A support. Each monthly support payment is to be made within 30 days

after the close of each calendar month. Should the monthly support payment due Evans not be paid within 30 days after the close of each calendar month, TD shall include in those payments interest equal to the 3-month commercial paper rate.

5. This resolution also directs TD to pay interest on the January 2003 monthly support payment.

6. Evans' depreciation study is adopted.

This Resolution is effective today.

I hereby certify that this Resolution was adopted by the Public Utilities Commission at its regular meeting on March 13, 2003. The following Commissioners approved it:

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WILLIAM AHERN
EXECUTIVE DIRECTOR

APPENDIX A

EVANS TELEPHONE COMPANY
TOTAL COMPANY RESULTS OF OPERATIONS
PRESENT RATES
TEST YEAR 2003

			Utility Exceed Staff Estimate	
	Evans	Staff	Amount	Percentage
OPERATING REVENUES				
Local Revenues	3,978,263	4,422,586	(444,323)	-11.17
CHCF-A	3,627,318	3,627,318	0	0.00
Intrastate:				
InterLATA Access Revenues	1,716,279	1,446,020	270,259	15.75
LATA Toll Revenues	1,921,527	2,382,117	(460,590)	-23.97
Interstate:				
Access Revenues	3,381,527	3,344,276	37,251	1.10
Miscellaneous Revenues	342,519	352,513	(9,994)	-2.92
Less: Uncollectibles	-95,712	-67,880	(27,832)	29.08
Total	14,871,721	15,506,950	(635,229)	-4.27
OPERATING EXPENSES				
Plant Specific	1,916,538	1,773,170	143,368	7.48
Plant Non-Spec. (less Dprn)	834,024	632,700	201,324	24.14
Customer Operations	1,674,404	1,406,895	267,509	15.98
Corporate Operations	4,454,705	3,412,432	1,042,273	23.40
Subtotal	8,879,671	7,225,197	1,654,474	18.63
Depreciation & Amortization	3,044,009	3,201,100	(157,091)	-5.16
Taxes Other Than on Income	165,319	76,424	88,895	53.77
State Income Tax	238,258	432,942	(194,684)	-81.71
Federal Income Tax	835,368	1,517,960	(682,592)	-81.71
Total	4,282,954	5,228,426	(945,472)	-22.08
Net Revenues	1,709,096	3,053,327	(1,344,231)	-78.65
RATE BASE				
2001 - Property, Plant & Equipment	37,724,333	35,374,940	2,349,393	6.23
2002 - Property Held for Future Use	0	0	0	0.00
2003 - Tel. Plant Under Constr. ST	358,237	358,237	0	0.00
2004 - Tel. Plant Under Constr. LT	0	0	0	0.00
1220 - Materials and Supplies	259,444	166,302	93,142	35.90
- Working Cash	860,988	716,843	144,145	16.74
Less: Depreciation	-22,097,651	-24,734,600	2,636,949	-11.93
Less: Deferred Tax & Customer CIAC	-573,458	-573,500	42	-0.01
Total	16,531,893	11,308,222	5,223,671	31.60
Rate of Return	10.34%	27.00%		

APPENDIX B

EVANS TELEPHONE COMPANY
SEPARATED RESULTS OF OPERATIONS AT PRESENT RATES
TEST YEAR 2003

	Evans			TD		
	Total Company	Interstate	Intrastate	Total Company	Interstate	Total Intrastate
OPERATING REVENUES						
Local Revenues	3,978,263		3,978,263	4,422,586		4,422,586
CHCF-A	3,627,318		3,627,318	3,627,318		3,627,318
Intrastate:						
InterLATA Access Revenues	1,716,279		1,716,279	1,446,020		1,446,020
LATA Toll Revenues	1,921,527		1,921,527	2,382,117		2,382,117
Interstate:						
Access Revenues	3,381,527	3,275,821	105,706	3,344,276	3,275,821	68,455
Miscellaneous Revenues	342,519		342,519	352,513		352,513
Less: Uncollectibles	(95,712)		(95,712)	(67,880)		(67,880)
Total	14,871,721	3,275,821	11,595,900	15,506,950	3,275,821	12,231,129
OPERATING EXPENSES						
Plant Specific	1,916,538	428,423	1,488,115	1,773,170	396,374	1,376,796
Plant Non-Spec. (less Dprn.)	834,024	189,996	644,028	632,700	144,133	488,567
Customer Operations	1,674,404	317,132	1,357,272	1,406,895	266,466	1,140,429
Corporate Operations	4,454,705	893,234	3,561,471	3,412,432	684,244	2,728,188
Subtotal	8,879,671	1,828,785	7,050,886	7,225,197	1,491,217	5,733,980
Depreciation & Amortization	3,044,009	702,885	2,341,124	3,201,100	739,160	2,461,940
Taxes Other Than on Income	165,319	38,003	127,316	76,424	17,570	58,854
State Income Tax	238,258	60,657	177,601	432,942	97,344	377,817
Federal Income Tax	835,368	212,673	622,695	1,517,960	341,305	1,324,683
Total	4,282,954	1,014,218	3,268,736	5,228,426	1,195,378	4,223,295
Net Revenues	1,709,096	432,818	1,276,278	3,053,327	589,226	2,273,854
RATE BASE						
2001 - Property, Plant & Equipment	37,724,333	8,672,078	29,052,255	35,374,940	8,132,699	27,242,241
2002 - Property Held for Future Use	0	0	0	0	0	0
2003 - Tel. Plant Under Constr. ST	358,237	82,352	275,885	358,237	82,359	275,878
2004 - Tel. Plant Under Constr. LT	0	0	0	0	0	0
1220 - Materials and Supplies	259,444	61,772	197,672	166,302	39,597	126,705
- Working Cash	860,988	197,924	663,064	716,843	164,802	552,041
Less: Depreciation	(22,097,651)	(5,106,813)	(16,990,838)	(24,734,600)	(5,716,166)	(19,018,434)
Less: Deferred Tax & Customer CIAC	(573,458)	(131,827)	(441,631)	(573,500)	(131,800)	(441,700)
Total	16,531,893	3,775,486	12,756,407	11,308,222	2,571,490	8,736,732
Rate of Return	10.34%	11.46%	10.00%	27.00%	22.91%	26.03%

APPENDIX C

THE EVANS TELEPHONE COMPANY
INTRASTATE RESULTS OF OPERATIONS AT ADOPTED RATE OF RETURN
TEST YEAR 2003

	Evans Proposed	TD Proposed	Utility Exceed Staff Amount	Percentage	Adopted
OPERATING REVENUES					
Local Revenues	3,978,263	4,422,586	(444,323)	(11.17)	4,422,586
CHCF-A	3,627,318	1,048,675	2,578,643	71.09	1,048,675
Intrastate:					
InterLATA Access Revenues	1,716,279	1,446,020	270,259	15.75	1,446,020
LATA Toll Revenues	1,921,527	2,382,117	(460,590)	(23.97)	2,382,117
Interstate:					
Access Revenues	105,706	68,455	37,251	35.24	68,455
Miscellaneous Revenues	342,519	352,513	(9,994)	(2.92)	352,513
Less: Uncollectibles	(95,712)	(67,880)	(27,832)	29.08	(67,880)
Total	11,595,900	9,652,486	1,943,414	16.76	9,652,486
OPERATING EXPENSES					
Plant Specific	1,488,115	1,376,796	111,319	7.48	1,376,796
Plant Non-Spec. (less Dprn.)	644,028	488,567	155,461	24.14	488,567
Customer Operations	1,357,272	1,140,429	216,843	15.98	1,140,429
Corporate Operations	3,561,471	2,728,188	833,283	23.40	2,728,188
Subtotal	7,050,886	5,733,980	1,316,906	18.68	5,733,980
Depreciation & Amortization	2,341,124	2,461,940	(120,816)	(5.16)	2,461,940
Taxes Other Than on Income	127,316	58,854	68,462	53.77	58,854
State Income Tax	177,601	116,294	61,307	34.52	116,294
Federal Income Tax	622,695	407,744	214,951	34.52	407,744
Total	3,268,736	3,044,832	223,904	6.85	3,044,832
Net Revenues	1,276,278	873,674	402,604	31.55	873,674
RATE BASE					
2001 - Property, Plant & Equipment	29,052,255	27,242,241	1,810,014	6.23	27,242,241
2002 - Property Held for Future Use	0	0	0	0.00	0
2003 - Tel. Plant Under Constr. ST	275,885	275,878	7	0.00	275,878
2004 - Tel. Plant Under Constr. LT	0	0	0	0.00	0
1220 - Materials and Supplies	197,672	126,705	70,967	35.90	126,705
- Working Cash	663,064	552,041	111,023	16.74	552,041
Less: Depreciation	(16,990,838)	(19,018,434)	2,027,596	(11.93)	(19,018,434)
Less: Deferred Tax & Customer CIAC	(441,631)	(441,700)	69	(0.02)	(441,700)
Total	12,756,407	8,736,731	4,019,676	31.51	8,736,731
Rate of Return	10.00%	10.00%			10.00%

APPENDIX D

THE EVANS TELEPHONE COMPANY
NET-TO-GROSS MULTIPLIER
TEST YEAR 2003

1	Gross Revenue	1.00000
2	Uncollectibles*	/
3	Net Revenue	1.00000
4	Corporate State Franchise Tax Rate (CCFT) at 8.84% (tax rate times line 3)	0.08840
5	Federal Taxable Income at 34% (line 3 less line 4)	0.91160
6	Federal Income Tax (tax rate time line 5)	0.30994
7	Net Income (line 5 less line 6)	0.60166
8	Net-to-Gross Multiplier (line 1 divided by line 7)	1.66208

Intrastate Revenue Requirement

9	Adopted State Rate Base	8,736,732
10	Adopted Rate of Return at 10.00% (line 9 times 10.00%)	873,673
11	Net Revenues at Present Rates	2,425,129
12	Net Revenue at Adopted Rates	869,612
13	Change in Net Revenues (line 10 less line 11)	(1,551,456)
14	Total Intrastate Revenue Requirement Change (line 13 times line 8)	(2,578,643)

CHCF-A Support

15	2003 CHCF-A Support at Present Rates	3,627,318
16	2003 CHCF-A Support Adopted	1,048,675

*Uncollectibles are included in line 1, Gross Revenue

APPENDIX E
ADOPTED CONDITIONS

(Decision 01-06-084)

The authority granted by this decision is contingent upon the following conditions:

1. Evans Telephone shall not sell any assets used or useful in the provision of its regulated services to satisfy debt obligations incurred by Country Road or Evans Holdings to finance the acquisition of the Evans Telephone or Evans Communications.

2. Evans Telephone shall not increase rates for its customers due to any increase in costs brought about by its acquisition by Country Road and Evans Holdings.

3. Evans Telephone shall manage its finances on a stand-alone basis, independent of Country Road, CRC Communications of California, and other affiliates.

4. Country Road and Evans Holdings shall provide Evans Telephone with sufficient equity capital to maintain a reasonable and balanced capital structure and to provide service to the public that is safe, reliable, and in compliance with all applicable statutes and Commission orders.

5. Evans Telephone shall comply with all existing and future affiliate rules and reporting requirements.

6. Evans Telephone shall not pay a dividend, loan money, or provide any other forms of capital to Country Road, Evans Holdings, or other affiliates if doing so would jeopardize the utility's ability to provide reliable service at reasonable rates.

7. Country Road shall invest approximately $11 million in network infrastructure for Evans Telephone over the next five years and increase the offering of broadband and other services to Evans Telephone customers, over current levels, without increasing local rates.

(END OF APPENDIX E)